



Memorandum

To : Luciana Profaca
Chief Deputy Director

From : Tina Watson (*signed copy on file*)
Chief, Audit Services

Date : June 17, 2008

Subject : **Audit of Fiscal Year 2004/2005 Case Service Contract #24609
with Foundation for Educational Achievement/Community
Options Division**

File No. : IVB2.83-1081

Introduction

The Department of Rehabilitation (DOR) Audit Services section has completed its audit of Case Service Contract (Contract) #24609 with Foundation for Educational Achievement (FEA)/Community Options Division in San Diego.

FEA is a non-profit organization that provides education and services that help individuals reach their full potential and improve the quality of their lives through continuous learning and achievement. Community Options, a division of FEA, was established in 1985 and offers life and employment skills for adults with developmental disabilities and services to senior citizens through its Senior Community Service Employment Program. Community Options helps people with developmental disabilities to make their own choices about where and how to live and work; and helps ensure people with developmental disabilities lead a life with dignity and respect by providing programs such as Integrated Employment, Supported Employment, Mobility Training, Assistive Technology Services, School to Work Transition Services, and Independent Living Services statewide.

For the fiscal year ended June 30, 2005, FEA reported total revenue of \$23,808,597, of which \$13,186,980 (55%) was from contracts and grants. The Contract, effective July 1, 2004 through June 30, 2005, was budgeted for

\$138,526 and FEA received contract payments from DOR totaling \$128,175. In addition, FEA also received \$498,516 from DOR Fee-for-Service payments.

For 23 years, Community Options was a division of FEA. Effective March 1, 2008, the organization formally became a free standing non-profit organization named Employment & Community Options (ECO). The services to DOR consumers continued uninterrupted under the new organization name; and ECO's current contract with DOR (#26769) is effective July 1, 2007 through June 30, 2010 for \$138,526. Thus, our recommendations will be issued to ECO.

FEA/Community Options Division was contracted to provide services to DOR consumers of all disabilities primarily in the north end of San Diego county and the Mission Valley area of the San Diego District. The services provided under this contract are designed to prepare the DOR consumer with the skills necessary to secure and maintain competitive employment in agreement with their Individual Plan for Employment (IPE) and included Employment Preparation, Job Development and Placement, and Retention and Follow-up. The Contract service goals were 100 unduplicated DOR consumers to receive Employment Preparation, 50 DOR consumers to be placed in unsubsidized, integrated and competitive employment consistent with their IPE, and 50 DOR consumers to obtain and retain unsubsidized, integrated, and competitive employment for 90 days or longer.

Scope

Audit fieldwork was conducted during June 2006 and the exit conference was held on June 16, 2006. We conducted our audit in accordance with Government Auditing Standards as defined by the Government Accountability Office, except for Standard 3.52 requiring an external peer review. These standards require that we obtain reasonable assurance that the expenditures incurred and the services provided are supported by appropriate records; and are in compliance with the Contract, 2004/05 Contract Manual (Contract Manual), and applicable State and Federal laws and regulations including the applicable Office of Management and Budget (OMB) Circulars. The audit also included a limited review of the internal controls applicable to the Contract. Our audit is subject to the inherent risk that all significant errors and irregularities, fraud, or non-compliance will not be identified.

Our audit included examining, on a sample basis, evidence supporting the information included on the Case Service Contract Budget and Reimbursement Requests (invoices) submitted to DOR. Our audit also included a limited review of the internal controls as they relate directly to our audit of the invoices through use of an accounting system and internal control questionnaire, and interviews with FEA/Community Options staff. A more comprehensive review of

organizational internal controls was not conducted due to our reliance on the unqualified audit report issued by FEA's independent auditor. In addition, we performed a limited review of other funding received by FEA from DOR to ensure that duplicate funding did not occur between funding sources; obtained an understanding of the services provided by FEA; and performed a limited review of the procedures in place to document and report the services provided to DOR consumers. We did not audit the DOR Fee-for-Service payments made to FEA/Community Options.

Findings and Recommendations

The services provided and expenditures incurred by FEA/Community Options are supported by appropriate records; and are in compliance with the Contract, Contract Manual, and applicable State and Federal laws and regulations including the applicable OMB Circulars except for the issues identified below. As a result of the findings identified, FEA/Community Options overbilled DOR by \$9,225 (Exhibit A).

It is important to note that many of the findings were caused by FEA/Community Options' lack of understanding and compliance with the Contract and Contract Manual terms and requirements which resulted in inadequate contract management practices. Specific details to the findings can be found in **Appendix I, Details to Findings**.

1. FEA/Community Options incorrectly invoiced DOR for operating expenses that were not allowable or not included in the approved Contract Budget Narrative resulting in an overbilling to DOR of \$9,225 (**Exhibit A**).

Recommendation:

ECO thoroughly review and ensure understanding of the Contract and Contract Manual, including items allowed under each line item in accordance with the Contract Budget Narrative, and the policies and procedures for requesting revisions and amendments to the Contract.

ECO ensure that invoices submitted to DOR only include expenses identified in the approved Contract Budget Narrative and do not contain unallowable costs. If ECO determines that addition of line items/expenses is warranted, it must submit a budget revision and/or amendment to request approval in accordance with the Contract and Contract Manual prior to incurring or billing these expenses.

Additionally, we suggest ECO review its contract line item descriptions against the account code descriptions in its general ledger and consider revising/amending the contract, as appropriate, to minimize the combining

of general ledger accounts into one contract line item. This would provide for a more efficient billing process, improve accuracy, and provide a better audit trail.

ECO remit the overbilling of \$9,225 to the DOR Accounting Section.

2. FEA/Community Options incorrectly billed personnel costs of \$5,145 for the Director of Career Services to the Employment Specialist 12.5% line item. However, since the duties performed by the Director would more likely fall under the Program Manager line item, and enough funds existed in the personnel budget category, no financial adjustment will be made.

Recommendation:

ECO ensure personnel costs are billed to the proper line item in accordance with the approved Contract Budget Narrative. If the line item does not exist, contact the DOR Contract Administrator for assistance in regards to a contract revision or amendment.

3. FEA/Community Options billed DOR for accrued contract staff pension costs that were not paid in accordance with OMB Circular requirements. Specifically, FEA accrued a 3% pension benefit for all employees for FY 2004/2005, including contract staff; however, FEA did not fund 2% of those costs within six months after the end of that year as required by regulations. We received documentation from FEA on July 31, 2006 confirming payment of the remaining 2% pension costs benefit; therefore, no audit adjustment will be made.

Recommendation:

ECO ensure that all accrued pension costs are paid within six months after the end of the fiscal year in accordance with OMB Circular A-122 to ensure allowability of the expense.

4. FEA/Community Options was not in compliance with the Contract since it used an arbitrary rate to bill Indirect Costs to DOR. In addition, the Contract Budget Narrative did not adequately detail the cost basis for the rate as required. During fieldwork, FEA provided an Indirect Cost Analysis with supporting accounting records and we verified that the indirect cost rate was higher (14.42%) than the budgeted 14% rate. Thus, no financial adjustment will be made.

Recommendation:

ECO develop and use an indirect cost rate based on actual costs incurred and paid, and retain records to support the indirect cost rate. Further,

ECO update the Contract to fully explain the basis for the indirect cost rate in the Contract Budget Narrative.

During the audit, the contents of this report were discussed with Nancy Batterman, President; Andrew Fons, Chief Financial Officer; John Filley, Director of Career Services; Patrick Hines, Program Manager; Jennifer Truong, Accounting Manager; Mary Ann Nucci, DOR Contract Administrator; and Jose Quintero, DOR Rehabilitation Supervisor. We appreciate their assistance with our audit.

The audit was conducted by David Kwan and Antonio De La Torre, DOR Auditors, under the supervision of Lori Bruno, DOR Audit Supervisor.

ECO Response

ECO submitted its response (**Exhibit B**) to the audit report on May 22, 2008, indicating it generally agreed with each of the findings and recommendations; and asking for relief from the repayment of that portion of the overpayment that resulted from errors in not amending the contract.

DOR Contract Administrator Follow-up

The DOR Contract Administrator shall perform a follow-up review on the findings to ensure the issues have been appropriately resolved. Once follow-up has been conducted, the DOR Contract Administrator shall submit a report to DOR Audit Services, Attn: Lori Bruno, by **August 15, 2008**. The follow-up report shall address each audit finding/recommendation separately, include an explanation of the specific review procedures conducted and supporting records reviewed by the DOR Contract Administrator, and indicate whether the finding has been resolved.

**FEA/Community Options
Case Service Contract #24609 for Fiscal Year 2004/2005**

Details to Findings

The services provided and expenditures incurred by FEA/Community Options are supported by appropriate records; and are in compliance with the Contract, 2004/05 Contract Manual (Contract Manual), and applicable State and Federal laws and regulations including the applicable Office of Management and Budget (OMB) Circulars except for the issues identified below. It is important to note that many of the findings were caused by FEA/Community Options' lack of understanding and compliance with the Contract and Contract Manual terms and requirements which resulted in inadequate contract management practices.

Effective contract management practices include reading the Contract and Contract Manual to identify expenses that can and cannot be charged to the Contract, to ensure understanding of the specific services to be provided under the Contract, and to identify what specific expenses are included in the Contract Budget Narrative. This will assist in properly processing and recording cost reimbursement contracts. Subsequently, expenses charged to the contract should be monitored to determine what costs are charged to the contract, that expenses are charged to the correct line item, and for comparison of budget to actual costs.

Operating Expenses

1. FEA/Community Options incorrectly invoiced DOR for unallowable operating expenses resulting in an overbilling to DOR of \$9,225 (**Exhibit A**).
 - a. The Rent and Utilities line item included rent expense for the Metro Career Center, located at 3910 University Avenue, which was not included in the approved Contract Budget Narrative. As a result, DOR was overbilled by \$6,173 for the period of October 1, 2004 through June 30, 2005.

The approved Contract Budget Narrative only included rent and utilities expenditures for the North County Inland Career Center on East Valley Parkway in Escondido; and the South Metro Career Center on Imperial Avenue in San Diego. FEA/Community Options did not submit a contract amendment to DOR in regards to the addition of this office space as required by Contract Exhibit B and the Contract Manual.

- b. The Rent and Utilities line item included cellular phone expenditures which were not included in the approved Contract Budget Narrative resulting in a total overbilling of \$700 (Exhibit A, Schedule 1).

The approved Contract Budget Narrative states that the Rent and Utilities line item includes rental costs and utilities for the North County Inland Career Center and the South Metro Career Center. This line item does not include provisions for cell phone expenditures. FEA/Community Options did not submit a contract amendment in regards to the addition of a telephone line item as required by Contract Exhibit B and the Contract Manual.

- c. The Office Supplies, Printing, Postage, and Publications line item included travel expenses, conference/seminar expenses, cellular phone expenses, and promotional expenses which were not included in the approved Contract Budget Narrative resulting in a total overbilling of \$653 (Exhibit A, Schedule 2).

The approved Contract Budget Narrative for the Office Supplies, Postage, Printing, and Publications line item includes the purchase of office supplies, postage, duplicating of materials, and the purchase of various resource materials used for computerized training programs and publications. Additionally, subscriptions are purchased through local newspapers and other publications to assist DOR clients in their job search. This line item does not include provisions for cell phone expenses, travel, conference/seminars, or promotional items. FEA/Community Options did not submit a contract amendment in regards to the addition of line items as required by Contract Exhibit B and the Contract Manual.

- d. The Mileage line item included conference/seminar expenses and training/in-service expenses which were not included in the approved Contract Budget Narrative resulting in a total overbilling of \$351 (Exhibit A, Schedule 3).

The approved Contract Budget Narrative for the Mileage line item includes reimbursement for mileage expenses accrued by FEA staff in the course of carrying out business and services to DOR clients. The Employment Specialists will make contacts in person with employers throughout the community. This line item did not include provisions for conference/seminar expenses or training/in-service expenses.

- e. FEA/Community Options billed DOR for an inkjet printer under the Office Supplies, Printing, Postage, and Publications line item; however, the inkjet printer is considered equipment and is therefore unallowable. As a result, DOR was overbilled by \$215.

The DOR has identified printers as equipment, which is unallowable under the Contract and Contract Manual. The Contract Manual *Contract Budget Expenditures and Line Items Not Allowed* states that the purchase of equipment is an unallowable expenditure and will not be paid under the contract.

In addition, the approved Contract Budget Narrative for the Office Supplies, Postage, Printing, and Publications line item includes the purchase of office supplies, postage, duplicating of materials, and the purchase of various resource materials used for computerized training programs and publications. Additionally, subscriptions are purchased through local newspapers and other publications to assist DOR clients in their job search. This line item does not include provisions for purchase of equipment.

- f. As a result of the operating expense audit adjustments noted in Finding 1.a. through Finding 1.e., Indirect Costs were overbilled by \$1,133 (Exhibit A) based on the 14% Indirect Cost rate applied by FEA/Community Options.

The approved Contract Budget Narrative states that the indirect cost rate is calculated at 14%, which reflects administrative costs of providing the contract services. The total direct cost for the contract is multiplied by 14%.

Our review found that FEA/Community Options utilizes a worksheet to prepare the billings to DOR which included general ledger expense categories that were unallowable or not included in the approved Contract Budget Narrative. This practice resulted in the disallowances noted above.

FEA/Community Options explained that it assumed DOR could be billed for these operating expenses since the costs were incurred in the provision of contract services. FEA/Community Options stated it was not aware that formal approval via a revision or amendment was required prior to billing DOR for the expense.

The Contract Exhibit B.IV. states there are no oral understandings or agreements that are not incorporated in this contract. Further, Exhibit

B.VI. states any alterations or variations to the contract must be contained in a written contract budget revision approved by the State's Contract Office and/or written contract amendment, approved by the Department of General Services.

Recommendation:

ECO thoroughly review and ensure understanding of the Contract and Contract Manual, including items allowed under each line item in accordance with the Contract Budget Narrative, and the policies and procedures for requesting revisions and amendments to the Contract.

ECO ensure that invoices submitted to DOR only include expenses identified in the approved Contract Budget Narrative and do not contain unallowable costs. If ECO determines that addition of line items/expenses is warranted, it must submit a budget revision and/or amendment to request approval in accordance with the Contract and Contract Manual prior to incurring or billing these expenses.

Additionally, we suggest ECO review its contract line item descriptions against the account code descriptions in its general ledger and consider revising/amending the contract, as appropriate, to minimize the combining of general ledger accounts into one contract line item. This would provide for a more efficient billing process, improve accuracy, and provide a better audit trail.

ECO remit the overbilling of \$9,225 to the DOR Accounting Section.

Personnel

2. FEA/Community Options incorrectly billed personnel costs of \$5,145 for the Director of Career Services to the Employment Specialist 12.5% line item.

Specifically, a percentage (6%) of the Director of Career Services (Director) personnel costs was billed to the Employment Specialist line item, which requires that the contract staff provide direct employment services to DOR consumers. However, based on interviews conducted with the contract staff and the Director, the Director's activities actually performed for the contract consisted of guidance/consulting services to the contract direct services staff on the challenging cases in which he has expertise of atypical, visual impairment, or autism consumers. However, since the duties performed by the Director would more likely fall under the Program Manager line item, and enough funds existed in the personnel budget category, no financial adjustment will be made.

According to the Director's duty statement, he coordinates overall management of vocational services including DOR funded programs as well as Department of Labor. His management duties included providing support, supervision and training to management staff to ensure quality services and state of the art practices including vocational/career training, and implementation of DOR IPE goals; and to monitor and meet DOR contract obligations.

The approved Contract Budget Narrative states the Employment Specialist performs employment preparation, job development and placement activities for DOR clients, including conducting employment preparation sessions, developing job search/placement strategies; resume/application training, and contacting local employers performing job development activities on behalf of DOR consumer job placement files.

The approved Contract Budget Narrative states the Program Manager will be responsible for the programmatic and administrative supervision of the Contract to include Employment Services. Duties noted include: coordinate, supervise and manage the activities of the Contract with DOR; hire, train, and supervise all personnel; establish program operating plans and budgets; monitor fiscal activities, negotiate Contracts with DOR, write and report case service monthly program goals; provide employment preparation activities, conduct job development activities for DOR clients, and supervise job placement as needed in conjunction with the Employment Specialist.

Recommendation:

ECO ensure personnel costs are billed to the proper line item in accordance with the approved Contract Budget Narrative. If the line item does not exist, contact the DOR Contract Administrator for assistance in regards to a contract revision or amendment.

3. FEA/Community Options billed DOR for accrued contract staff pension costs that were not paid in accordance with OMB Circular requirements. Specifically, FEA accrued a 3% pension benefit for all employees for FY 2004/2005, including contract staff; however, FEA did not fund 2% of those costs within six months after the end of that year as required by regulations.

OMB Circular A-122, Cost Principles for Non-Profit Organizations, Attachment B.8.i.(d) *Pension Plan Costs* states that costs of the organization's pension plan which are incurred in accordance with the

established policies of the organization are allowable, provided that the costs assigned to a given fiscal year are funded for all plan participants within six months after the end of that year.

FEA explained it had not been able to pay the 2% balance of the accrued pension costs due to cash flow issues of the organization. During audit fieldwork, the Chief Financial Officer (CFO) stated the balance of accrued pension costs due would be made within the next two weeks after the finance committee meeting. We received documentation from FEA on July 31, 2006 confirming payment of the remaining 2% pension costs benefit; therefore, no audit adjustment will be made. However, FEA/Community Options was not in compliance with OMB Circular requirements regarding the allowability of pension costs.

Recommendation:

ECO ensure that all accrued pension costs are paid within six months after the end of the fiscal year in accordance with OMB Circular A-122 to ensure allowability of the expense.

Indirect Costs

4. FEA/Community Options was not in compliance with the Contract since it used an arbitrary rate to bill Indirect Costs to DOR. In addition, the Contract Budget Narrative did not adequately detail the cost basis for the rate as required.

During the audit we requested documentation to support the indirect cost rate billed to DOR; however, FEA stated that it had no documentation, that it was not aware where the rate came from, and that the rate had been in the contract for years and had never been questioned until our audit. FEA calculated the billable indirect costs using the subtotal of the Personnel and Operating expenses reported on the Service Invoices multiplied by the budgeted 14% rate. Further, we found the Contract Budget Narrative did not contain specific detail regarding the basis for the Indirect Cost rate, stating only "the rate is calculated at 14%, which reflects administrative costs of providing the contract services."

To determine whether the indirect cost rate could be supported, we requested that FEA provide an Indirect Cost Analysis that identified two methods for FY 2004/2005. We reviewed the Indirect Cost Analysis with the supporting accounting records and verified that the indirect cost rate based on actual expenses was 14.42%, slightly exceeding the budgeted 14% rate. Thus, no financial adjustment will be made.

The Contract Service Budget (DR801A) states that indirect costs are allowable costs incurred by an organization, which support the activities of a program or contract, but are not directly assigned to the specific program or contract and are allocated to the program or contract using a method in compliance with OMB circulars. The allocation method must be fully explained in the contract budget narrative and must be supported by actual costs incurred and paid by the organization. The allocation of indirect costs cannot be based on an arbitrary rate.

Recommendation:

ECO develop and use an indirect cost rate based on actual costs incurred and paid, and retain records to support the indirect cost rate. Further, ECO ensure its current contract fully explains the basis for the indirect cost rate in the Contract Budget Narrative.

EXHIBIT A

FEA/Community Options - ECO
Case Service Contract #24609 for Fiscal Year 2004/05

Schedule of Overbilling

Finding Number	Contract Line Item	Overbilling
1a	Rent and Utilities	\$6,173
1b	Rent and Utilities (Exhibit A, Schedule 1)	\$700
1c	Office Supplies, Printing, Postage, Publications (Exhibit A, Schedule 2)	\$653
1d	Mileage (Exhibit A, Schedule 3)	\$351
1e	Office Supplies, Printing, Postage, Publications	\$215
	Sub-Total	\$8,092
1f	Indirect Cost (14% per Contract)	\$1,133
	Total Due to DOR	\$9,225



Employment & Community Options
8555 Aero Drive, Suite 102
San Diego, CA 92123
(858) 565-9870 Office • (858) 565-9875 Fax

May 22, 2008

Tina Watson
Chief, Audit Services
721 Capitol Mall, 3rd Floor
Sacramento, CA 95814

Dear Ms. Watson:

We appreciate the opportunity to respond to this report. Through this contract, Employment and Community Options (and its antecedent, the Foundation for Educational Achievement) has been providing valuable job placement assistance to clients of the Department of Rehabilitation for over 20 years. We have been successful over the long run because of our focus on the needs and goals of the DOR clients we assist. We have a long history of meeting and exceeding contract performance goals. During the program year in question, our performance goals were to serve 100 clients and place 50 in suitable and gainful employment. The actual performance of the program that year resulted in 116 clients being served and 66 being placed. We achieved this performance for a total cost of \$128,175.26 in FY 05. The contract budget that year was \$138,526. As you can see, we exceeded the contract goals while spending \$10,351 less than what the contract allowed. We believe we served the Department well in FY 2005.

We acknowledge that we made errors with regard to billing and welcome the recommendations. The recommendations included in the reports were provided to us at the exit interview two years ago and have already been incorporated into our accounting procedures. We are also working very closely with the DOR Contract Administrator to ensure that expenditures follow the specifics of the contract very closely. Since this audit we have developed a stronger relationship with our Contract Administrator to insure that we comply with all of the amendment procedures. We have also used the amendment procedures to make necessary and agreed upon changes to our current contract. The issues that created the errors have been rectified.

The errors we made were errors of omission that involved not keeping the language of the contract current with actual expenditures. With the exception of

the purchase of an inexpensive printer, these errors did not involve expenses that would have been disallowed had we followed the proper contract amendment procedures. We only billed for expenses that were incurred during the provision of direct services to clients as part of this contract. The success we achieved in serving clients that year demonstrates this. The rent charged to this contract was for the Employment Specialist, however the location of the office moved. We do now know that we need to get these items approved through contract amendment procedures.

In conclusion, we would assert that while errors were made, good services were provided to clients, performance goals were exceeded, and services were provided economically to the Department. All areas of concern have been rectified.

We are respectfully requesting relief from the repayment of that portion of the overpayment that resulted from our errors in not amending the contract. These costs were incurred in the provision of services to DOR clients. We are not requesting relief from repaying the cost of the printer as that would not have been an allowable cost even if included in the contract.

Sincerely,

A handwritten signature in cursive script that reads "Nancy Batterman".

Nancy Batterman
President/CEO